ORIGINAL

DOCKET FILE COPY ORIGINAL

RECEIVED

JUN 2 1 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	))))	MM Docket No. 92-266
	)	
Rate Regulation	)	

Petition for Reconsideration of Century Communications Corp.

BROWN & BAIN, P.A.
Lex J. Smith
Alan H. Blankenheimer
Joel W. Nomkin
Jodi K. Feuerhelm
Charles A. Blanchard
Shirley A. Kaufman
2901 North Central Avenue
Post Office Box 400
Phoenix, Arizona 85001-0400
(602) 351-8000

Attorneys for
Century Communications, Inc.

June 21, 1993.

No. of Copies rec'd 0+4
List A B C D E

Table of Contents

Summary

Century Communications, Inc. ("Century") owns fifty-eight cable systems that serve over 930,000 subscribers throughout the United States. [Declaration of Bernard P. Gallagher (6/17/93) at ¶ 1 ("Gallagher Decl.")] Century petitions for reconsideration of the Commission's Report & Order ("Order") released in this proceeding on May 3, 1993.

The Order implements, as the primary vehicle for cable rate regulation, a benchmark method that does not even try to take into account the need for cable operators to earn a reasonable profit or cover their costs. To the contrary, the Commission acknowledges

faced competition. And by forcing that firm to charge a regulated rate below its competitive level, the benchmark deprives it of a reasonable return on its investment.

Nor are these results avoided by the cost-of-service provisions of the Order. As the Commission acknowledges, cost-of-service regulation is contrary to the Cable Act's intent that cable systems not be subject to complex and costly utility-type regulation. In any event, cost-of-service is not a viable alternative, particularly because the Commission has not yet promulgated cost-of-service regulations, instead leaving the issue to the unfettered discretion of local authorities.

This petition presents Century's first opportunity to bring these failings to the attention of the Commission. Contrary to the requirements of the Administrative Procedure Act, the Commission failed to give notice or an opportunity for comment on the most basic aspects of the benchmark (including the statistical a reasonable profit. That failure violates the express terms of the Cable Act.

The Act directs that the Commission, in setting reasonable rates, "shall take into account," among other factors: (i) the opportunity for cable systems to earn "a reasonable profit"; (ii) "the direct costs of obtaining, transmitting, and otherwise providing signals"; and (iii) "such portion of the joint and common costs (if any) of obtaining, transmitting and otherwise providing such signals . . . ." § 623(b)(2)(C) (emphasis added).

The legislative history confirms these unambiguous directives. The House Conference Report (at 63) declared that "cable operators are entitled to earn a reasonable profit" (emphasis added). Similarly, the House Report (at 82) recognized

> "that the cost of providing this basic service tier could vary substantially from system to system, depending upon the market and the particular characteristics and configuration of the cable system."

Accordingly, the Committee stated that

> "[t]he formula the Commission shall establish pursuant to this section must take into account the direct costs of obtaining, transmitting, and otherwise providing signals required of the basic tier and the portion of the properly allocated joint common costs of the cable operator incurred in providing the basic service tier."

Id. (emphasis added).

The benchmark formula violates these directives. The benchmark tables are based solely on the revenue information collected by the Commission in its cable television rate survey. That survey did not even ask for information on whether the surveyed systems were earning a profit. Thus, contrary to the Act, there is no basis on which to conclude that the benchmark tables provide for a "reasonable profit."

Likewise, the survey solicited no cost information. As the Order (¶ 207) acknowledges, "there is simply insufficient information in the record to permit identification of typical system costs." In view of this failing, the Order (¶ 262) acknowledges that the benchmark formula may yield a rate below the rate to which a cable operator may be entitled under the Act:

> "the starting price cap level is based on industry-wide data and does not necessarily reflect individual systems' costs of providing cable service. Thus, we cannot be certain that the initial capped rate defined through benchmark comparisons will permit all cable operators to fully recover the costs of providing basic tier service and to continue to attract capital. We do not believe that Congress intended that cable operators could, or should, be compelled to provide basic tier service at rates that do not recover such costs."

The benchmark's failure to take profit or costs into account is particularly significant given the information from commenters that systems subject to effective competition have not earned profits. See Order ¶ 200 & n. 509 (collecting comments from "several parties" indicating that "rates charged by systems subject to effective competition would be skewed since short-term price wars in overbuild situations have created artificially low rates"). Basing the benchmark on the rates of systems that have not earned profits necessarily denies to cable operators their statutory right to earn a profit.

This failing of the benchmark is especially grave as applied to Century. Even before the Order issued, Century's cable systems were not earning a net profit. [Gallagher Decl. at ¶ 4] Century's preliminary assessment is that implementation of the benchmark formula would require Century's systems to reduce rates by up to fifteen percent, resulting in an aggregate revenue loss of approximately fifteen to thirty million annually. [Gallagher Decl. at ¶ 5] Should such rate reductions be implemented, Century would be unable to generate sufficient income to cover all of its operating and capital expenses. [Gallagher Decl. at ¶ 6] Indeed, Century's present assessment is that, with respect to one of its systems, implementation of the benchmark rates would provide insufficient income to permit that system to comply with loan covenants on a $68.5 million obligation. [Gallagher Decl. at ¶ 7]

Other cable companies face the same problem. As stated by one cable operator with 12,000 subscribers and cumulative system losses in excess of $1.6 million even <u>before</u> any rate reductions: "The revenues we calculate we would receive under the benchmark rates are insufficient to cover our current costs of doing business" and would "make it impossible" to "service . . . existing debt as it is now structured." [Declaration of D. Jack Stock (6/16/93) at ¶¶ 5-6; see also Declaration of Stanley Searle (6/17/93) at ¶¶ 4-7 (benchmark would require 26% rate reduction; because projected cash flow would be "insufficient to maintain operations," company would not be able to continue providing service to 157 subscribers in rural area) ("Searle Decl."); Declaration of David Kinley (6/17/93) at ¶ 6 (benchmark would require 26.4% rate reduction, resulting in a 20.6% revenue loss; "[t]he revenues we calculate we would receive . . . are insufficient to meet our current expenses for the System, including principal and interest payments") ("Kinley Decl."); Declaration of Gilbert R. Clark Jr. (6/16/93) at 2 (benchmark would require an average rate reduction of 15%; resulting revenues would be insufficient to meet current expenses); Declaration of Jay Busch at ¶ 8 (if revenues were reduced to benchmark rates, the "system's net loss would increase to the point where revenues would not cover all of the current interest expense . . . ."); Declaration of Arizona Cable TV Association (6/17/93) at ¶ ¶ 7, 10 ("The ability of ACTA's member organizations to service existing debt and obtain additional working capital loans will be substantially impaired if benchmark rates are adopted"; "Many small system members of ACTA have indicated that they will find their businesses in jeopardy if they have to continue with a 'benchmark' rate")].

II. THE BENCHMARK'S RELIANCE ON THE "AVERAGE" OF RATES CHARGED BY SYSTEMS FACING EFFECTIVE COMPETITION COMPOUNDS ITS STATUTORY DEFICIENCIES AND IS ARBITRARY AND CAPRICIOUS.

By basing the benchmark formula on the "average" of rates charged by systems subject to effective competition, the Order: (i) improperly regulates rates above that average; (ii) arbitrarily and capriciously discriminates between similarly situated systems; and (iii) makes it even less likely that cable operators will earn a profit or recover their costs.

The Act conclusively presumes that the rates of cable systems subject to effective competition are reasonable. Thus, the rates of such systems are not "subject to regulation," regardless of whether those rates are above the average of like systems. Cable Act, § 623(a)(2). The rates of other systems (i.e., systems not subject to effective competition) are subject to regulation, but only to ensure that the rates for such systems do not "exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition." § 623(b)(1) (emphasis added).

The benchmark goes well beyond this grant of regulatory authority. The Act deems rates to be reasonable if they do not "exceed" the rates that would be charged by systems facing effective competition--it does not say (as the regulations purport to require) that cable systems may not exceed the average of competitive rates. Thus, the Act permits a system to charge the same rate as a like system facing competition (even if that rate happened to exceed the "average" of competitive rates). Put differently, if a system facing competition charges a certain rate, then, whether or not that rate is above the "average," other systems (i.e., those not facing competition) charging the same rate, by definition, do not "exceed" that rate.[1]

[1] In no circumstance should a system be required to charge a rate that does not return a "reasonable profit" under § 623(a)(2).

The benchmark's reliance on this "average" results in irrational discrimination among similarly situated cable systems. A simple illustration makes the point. Assume that:

> (i) Systems A and B each offers the same number of channels, serve the same number of subscribers and have the same number of satellite-delivered signals (i.e., the "three key system characteristics" considered in the benchmark [Order ¶ 210]);
>
> (ii) System A is subject to effective competition, but its rates are above the average rates of systems subject to effective competition; and
>
> (iii) System B is not subject to effective competition, but charges the same rates as System A.

Under the Cable Act, System A's rates cannot be regulated (i.e., are deemed reasonable) even though they are above the average of all systems subject to effective competition. But under the benchmark, System B must reduce its rates below those of System A.

This disparate treatment of companies having the same "key system characteristics" offends basic principles of equal protection. At minimum, such treatment is "arbitrary [and] capricious." 5 U.S.C. § 706(2)(A).

Moreover, in forcing operators to charge at or below the "average" rates of competitive systems, the benchmark makes it all the more probable that operators will not earn a "reasonable profit" under § 623(b)2)(C). Even if some systems facing effective competition earn a profit, many do not because of below-cost pricing. See Order ¶ 200. Entering the rates of such unprofitable firms into the mix that constitutes the "average" is likely to yield a rate well below that contemplated by § 623(b)(2)(C).

III. THE BENCHMARK'S FAILURE TO ALLOW A REASONABLE RATE OF RETURN RESULTS IN AN UNCONSTITUTIONAL "TAKING" THAT IS NOT AVOIDED BY THE COST-OF-SERVICE OPTION.

The benchmark's failure to allow cable operators such as Century to earn a fair rate of return not only violates the Cable Act, it violates the Takings Clause of the Fifth Amendment. That Clause entitles a regulated company to earn a reasonable rate of return on its investment:

> "[I]t is important that there be enough revenue not only for operating expenses but

A. Cost-of-Service Regulation Is Forbidden Utility-Type Regulation.

The Cable Act requires the Commission, in establishing cable rate regulations, "to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission . . . ." § 623(b)(2)(A). Cost-of-service regulation does not fulfill that mandate. As the Order (¶ 186) observes, such regulation "imposes heavy burdens upon regulators and regulatees because of the significant administrative and compliance costs associated with this regulatory model." Accordingly, in the Commission's own words, cost-of service regulation is "inconsistent with the legislative intent." Notice of Proposed Rulemaking, 58 Fed. Reg. 48, 56 ("Notice") (Jan. 4. 1993).

The legislative history of the Cable Act expressly instructs the Commission not to use cost-of-service regulation:

> "The Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone common carriers. It is not the Committee's intention to replicate Title II regulation. The FCC should create a formula that is uncomplicated to implement, administer, and enforce, and should avoid creating a cable equivalent of a common carrier 'cost allocation manual.'" [House Report at 83]

Congress also rejected cost-of-service regulation in Section 621(c) of the 1984 Cable Act, which is left intact by the 1992 Cable Act: "[a]ny cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service."

rights of such operators to "earn[] a reasonable profit" [Order ¶ 10; accord id., §§ 270 (recognizing that Cable Act "envisions that the Commission, not local authorities, will establish standards and procedures for rate regulation of the basic service tier," including standards for cost-of-service regulation); 401]. Contrary to this legislative command, however, the Commission has not adopted such regulations. Instead, until regulations are promulgated, it is leaving cost-of-service determinations to ad hoc and standardless adjudications by local authorities.

The Commission's approach ignores that where, as here, a statute expressly instructs an agency to formulate policy through rulemaking, the agency lacks discretion to do so through adjudication instead. See, e.g., Pulido v. Heckler, 758 F.2d 503, 506 (10th Cir. 1985). Yet, that is exactly what the Commission has announced it will do. Accordingly, the Order is "not in accordance with law" and must be set side. See 5 U.S.C. § 706(2)(A).

Even if the statute did not expressly call for regulations, the Commission's failure to promulgate cost-of-service rules would still be unlawful because the absence of such rules leaves the Commission and franchising authorities unrestrained discretion in ruling on cost-of-service showings by cable operators. Such unrestrained adjudicatory authority violates due process. See, e.g., Holmes v. New York City Hous. Auth., 398 F.2d 262, 264-65 (2d Cir. 1968) ("It hardly need be said that the existence of an absolute and uncontrolled discretion in an agency of government vested with the administration of a vast program . . . would be an intolerable situation"); Hornsby v. Allen, 326 F.2d 605, 610 (5th Cir. 1964) (holding that plaintiff was denied due process because she "was not afforded an opportunity to know, through reasonable regulations promulgated by the board, of the objective standards which had to be met to obtain a license").

Moreover, leaving government agencies unrestrained discretion to regulate First Amendment speakers, such as cable operators, that defies rational business planning: cable operators have no way of knowing what costs they may include in their rate bases, what kind of depreciation schedules will be applied, or what rates of return they will earn. Moreover, without that basic information, operators cannot assure lenders and other sources of capital that they will have the cash flow required to service their current financial obligations. See Gallagher Decl. at ¶ 10; Kinley Decl. at ¶ 11; see also Searle Decl. at ¶ 9 ("the cost of service option may not be a viable option inasmuch as the commission has not decided whether debt service will be a recoverable cost").

Second, the Order compounds the wildcard nature of the cost-of-service alternative by providing that, if a cable operator elects that method, it "assumes the risk" that its rates may be reduced to a level below the level it would have obtained under the benchmark method. Order ¶ 272; accord id., ¶¶ 136, 138, 173 n. 456, 371.

Third, even if a an operator's rates would be justified by whatever cost-of-service standards ultimately are adopted, the operator may be barred from charging those rates for such a operator's cost-of-service showing. But the operator will have been prevented for all those years from charging rates justified by its cost-of-service. And it will never be able to recoup the difference between those rates and the lower rates to which it improperly was held hostage. See Birkenfeld v. City of Berkeley, 17 Cal. 3d 129, 169, 130 Cal. Rptr. 465, 494 (1976) (rent control law violates due process because its procedures were so cumbersome and time-consuming; "The charter amendment is constitutionally deficient in that it withholds powers by which the rent control board could adjust maximum rates without unreasonable delays and instead requires the Board to follow an adjustment procedure which would make such delays inevitable").[4]

IV. THE ORDER VIOLATES THE ADMINISTRATIVE PROCEDURE ACT.

A. The Commission Failed to Give Adequate Notice of How the Benchmark Rates Would be Developed and Used.

A notice of proposed rulemaking must give adequate notice of "either the terms or substance of the proposed rule or a

[4] The Order's allowance for cable operators to offer service on a pay-per-channel (a la carte) basis does not alleviate the problems with the benchmark and cost-of-service methods because the Commission has made clear that it might consider the a la carte approach to be an "evasion" of its regulations. See § 76.921(d) ("Any retiering of channels or services that is not undertaken in order to accomplish legitimate regulatory, technical, or customer service objectives and that is intended to frustrate or has the effect of frustrating compliance with paragraphs (a) through (c) of this Section is prohibited"); Order ¶ 453, n. 1161 ("we do not, in the absence of a particular factual context, decide whether a shift of programming from a tier to an 'a la carte' offering in and of itself would constitute evasion"). Additionally, as the Order (¶ 453 n. 1161) recognizes, there is great doubt that cable operators could "as a business matter . . . shift programming previously offered as part of a tier to 'a la carte' status . . . ."

description of the subjects and issues involved." 5 U.S.C. § 553(b)(3). While a final rule need not be identical to that discussed in the notice of proposed rulemaking, "if the final rule deviates too sharply from the proposal, affected parties will be deprived of notice and an opportunity to respond to the proposal." Small Refiner Lead Phase-Down Task Force v. EPA, 705 F.2d 506, 547 (D.C. Cir. 1983). Accordingly, a final rule violates the notice-and-comment requirement unless it is a "'logical outgrowth'" of the rulemaking proceeding. AFL-CIO v. Donovan, 757 F.2d 330, 338 (D.C. Cir. 1985). This test is a common sense one: the notice is inadequate unless "given a new opportunity to comment, commentators would not have their first occasion to offer new and different criticisms which the Agency might find convincing." BASF Wyandotte Corp. v. Costle, 598 F.2d 637, 642 (1st Cir. 1979), cert. denied, 444 U.S. 1096 (1980).[5]

The benchmark rates for basic service in the Order are not the logical outgrowth of the rulemaking process. Critically, the Notice of Proposed Rulemaking failed to disclose that the benchmark rates would give no regard to system profitability. Moreover, while the Notice suggested that "regression analysis or some other

---

[5] Notice is not merely a formal requirement of rulemaking. It serves at least three distinct functions: it improves the quality of rulemaking by ensuring that agency regulations will be tested by exposure to diverse public comment; it recognizes that the opportunity to be heard is an essential component of fairness to affected parties; and it gives parties an opportunity to develop evidence in the record to support their objections to a rule and thereby enhances the quality of judicial review. Small Refiners Lead Phase-Down Task Force, 705 F.2d at 547.

statistical technique could be used to determine how rates varied with such characteristics affecting costs," and that "[w]ith this information, [the Commission] could create a benchmark formula based upon systems subject to effective competition" [Notice at 54], there was no notice--and hence no opportunity for any meaningful comment--on even the most basic aspects of the methodology that would be used to determine the benchmark. Based on a reading of the various notices released by the Commission in these proceedings, a party could not logically predict how the Commission would determine benchmark rates. Indeed, none of the following was disclosed in the rulemaking proceedings until the Final Order:

(i) The statistical tool that would be used to create a benchmark, or the particular model that would be used for any multiple regression analysis. Without notice and comment, the Commission decided to use multiple regression analysis (despite the availability of several statistical alternatives) and chose a logarithmic model (despite the fact that there were "various formulations of the model" available [Appendix E ¶ 26]).

(ii) Which of the many identified factors affecting cost that would be taken into account, or even the process by which these factors would be chosen. Despite the availability of numerous cost factors (including line miles of distribution plant, density, percentage of plant below ground, etc.), the Commission--without notice--based the benchmark on only three cost factors.

(iii) The assumptions that would be made in creating the benchmark formula, including, for example, the assumptions that prices are in equilibrium, that community units in competitive markets are not facing price wars, and that the determinants of prices per channel are the same for competitive and non-competitive firms. The Commission's survey makes these and other numerous assumptions [Appendix E ¶ 32]--none of which was subject to notice and comment.

(iv) The adjustments to subscriber rates and rates per channel that would be made to allow consistent treatment of cable operators, including adjustments to subscriber rates to take out the effect of franchise fees, adjustments to rates to include the total cost of equipment, and adjustments to the rates to give greater weight to those with a greater number of subscribers. While Appendix E (¶¶ 14-24) devotes close to five full pages to the adjustments made to the data, none of these adjustments was ever released for public comment.

(v) The treatment of uncertainty in the statistical results. The Commission admits that "the data set does contain errors, and [that] information on variables likely to affect prices, such as local price levels for goods and services and geographic conditions, was unavailable." [Appendix E ¶ 31] The result, as the Commission admits, is that "the standard errors of the estimate are relatively large." [Id.] Accordingly, while one of the most important issues faced by the Commission was how the benchmarks would be adjusted to reflect this uncertainty, there was no notice and comment on the issue.

The general notice given by the Commission is no substitute for its failure to disclose these basic aspects of the benchmark methodology. As the D.C. Circuit explained in Small Refiner Lead Phase-Down Task Force, 705 F.2d at 549:

"EPA also argues that it gave general notice informal rulemaking has an obligation to make its views known to the public in a concrete and focused form so as to make criticism or formulation of alternatives possible"), cert. denied, 434 U.S. 829 (1977).

Had the Commission given interested parties an opportunity to comment on the fundamentals of the benchmark methodology, they would have been able to identify problems that either would have caused the Commission to change its approach, or would have enhanced the quality of the administrative record for judicial review. The Commission's failure to give that opportunity renders the Order invalid. Weyerhaeuser Co. v. Costle, 590 F.2d 1011, 1031 (D.C. Cir. 1978) (where final rules "are the result of a complex mix of controversies and uncommented upon data and calculations," the rules must be vacated).[6]

B. The Order Failed To Give an Adequate Statement of Its "Basis and Purpose".

An agency must also give "a concise general statement of [the rule's] basis and purpose." 5 U.S.C. § 553(c). This requirement reflects that rulemaking is intended to be a "two-way street: the opportunity to comment is meaningless unless the agency responds to significant points raised by the public." Home Box Office, 567 F.2d at 35-36. The requirement of a concise statement means that

[6] The problems identified in this Petition and the petitions for reconsideration of other cable operators could have been brought forward to the Commission during the comment period had the Commission satisfied its obligation to give adequate notice.

agencies must respond "to [the] significant points raised" in rulemaking. <u>Home Box Office</u>, 567 F.2d at 35.

The Order violates this principle because it did not even attempt to respond to several significant concerns raised in comments about the benchmark approach. <u>First</u>, the Order notes--but makes no effort to respond to--the comment made by several

Second, the Order (including the explanation of the survey methodology in Appendix E) fails to respond to the flaws in the data identified by NCTA. As the Order itself acknowledges [Order, Appendix E ¶ 13, n. 11], NCTA discovered several "clear errors" with the survey data used to develop the benchmark, and identified those errors of sufficient magnitude to "affect in any important way the outcome of an analysis" such as that chosen by the Commission. [NCTA Comments at 8]. Rather than respond to these identified errors, the Order simply asserts--with no analysis--that the Commission did "not have any reason to believe that the use of [NCTA's improved data base] would have substantially changed our overall results." [Order, Appendix E ¶ 13, n. 11] This failure to respond to NCTA's comments was significant error. See St. James Hosp. v. Heckler, 760 F.2d 1460, 1469 (7th Cir.) ("We find that the Secretary's basis and purpose statement did not adequately respond to the criticisms raised in the many adverse comments . . . . First and foremost, the Secretary made no attempt to respond to comments that the Westat study was statistically unreliable"), cert. denied, 474 U.S. 902 (1985).[7]

Relief Requested

The deferral of the effective date of the Order to October 1, 1993, gives the Commission the opportunity to correct the

[7] Moreover, even if the Commission's undocumented assertion that the NCTA's identified data errors did not affect the "overall results" were correct, it does not follow that the specific benchmark figures that resulted from the survey data should not be adjusted.

deficiencies identified in this Petition. Revised cable rate regulations should be developed that take into account the right of cable carriers to earn a reasonable return on their investment, under a procedure that comports with the constitution and avoids subjecting carriers to complex utility-type regulation.

This Petition should be granted and the Order should be vacated.[8]

Respectfully submitted,

BROWN & BAIN, P.A.

By [signature]

Lex J. Smith
Alan H. Blankenheimer
Joel W. Nomkin
Jodi K. Feuerhelm
Charles A. Blanchard
Shirley A. Kaufman
2901 North Central Avenue
Post Office Box 400
Phoenix, Arizona 85001-0400
(602) 351-8000

Attorneys for
Century Communications, Inc.

---

[8] Century has supported the points raised in this Petition with relevant factual information. Because of the short time period for filing this Petition, however, other facts may come to light that would assist the Commission's resolution of these points. In that event, Century will supplement the record.